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June 5, 2000

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Surface Transportation Board
Office of the Secretary
Case Control Unit
Attn: STB Ex Parte No. 582 (Sub-No. 1)
1925 K Street, N.W.
Washington, DC 20423-0001

Re: STB Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation

Dear Secretary:

Enclosed for filing in the above-captioned docket are the original and twenty-five copies of the Comments of Consumers United for Rail Equity (CURE). Also enclosed is a 3.5 inch IBM compatible floppy disk containing an electronic copy of the Comments in WordPerfect 8.0, which is convertible to WordPerfect 7.

Thank you for your consideration.

Sincerely,

Robert G. Szabo

Robert G. Szabo
Executive Director and Counsel

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BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 582
(Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REPLY COMMENTS OF CONSUMERS
UNITED FOR RAIL EQUITY

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DATED: June 5, 2000

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 582
(Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REPLY COMMENTS OF CONSUMERS UNITED FOR RAIL EQUITY

Pursuant to the Surface Transportation Board's (STB) March 31, 2000 Decision in the above-captioned proceeding, Consumers United for Rail Equity (CURE), submit reply comments concerning possible modifications to the STB's Railroad Consolidation Procedures.[1/]

CURE is a coalition of rail shippers, including public power generators, rural electric cooperatives, investor owned electric utilities, coal producers, chemical and petrochemical companies, that rely on rail transportation but are sometimes "captive" to a single railroad for at least some of their rail movements. CURE advocates federal policies that will promote competition and increase efficiencies in the rail industry.[2/]

1/ 49 C.F.R. §§ 1180.0 --1180.9.

2/ CURE's membership includes the following: Algona Municipal Utilities; American Electric Power Service Corporation; American Public Power Association; Arizona Electric Power Cooperative; Arkansas Electric Cooperative Association; Buckeye Power, Inc; Camelot Coal Company; Caroline Power and Light Company; Consumers Energy Company; Dairyland Power Cooperative; Edison Electric Institute; Empire District Electric Company; Entergy Services, Inc.; Ethyl Corporation; Exelon Corporation; Kansas City Power and Light Company; Minnesota Power; Municipal Electric Systems of Oklahoma; National Rural Electric Cooperative Association; Nebraska Public Power District; The Ohio Valley Coal Company; Potomac Electric Power Company; Shawnee Coal Company; Southern Indiana Gas and Electric Company; Sunoco, Inc.; Western Fuel Association; and Wisconsin Power and Light Company.

CURE agrees with the many shippers, short line and regional railroads, state and federal agencies, and public officials participating in this proceeding who believe that current rail merger policy and other rail policies have failed to promote effective competition in the rail industry today. CURE also agrees with the major railroads participating in this proceeding who conclude that regulatory changes are needed to meet the current challenges posed by a railroad industry that is markedly changed from the late 1970's and early 1980's. Unfortunately, while some of the major railroads have correctly diagnosed the illness, their prescription for restoring health to the rail industry amounts to little more than a placebo. In contrast, CURE has identified in its comments to the STB in this proceeding, a series of actions that will interject competition into the rail industry, thus promoting its future health and benefitting railroad customers.

CURE Recommends Policy Changes That Will Promote Effective Rail Competition in Major Rail Merger Proceedings and as General National Rail Policy.

Virtually every participant in this proceeding agrees that the existing regulatory framework is inadequate to deal with the current market structure and framework of the major railroad industry. The recently announced proposed merger between the Burlington Northern and Sante Fe Rail Company (BNSF) and the Canadian National Railway Company (CN) leads many informed observers of the rail industry to conclude that this merger, if successful, will trigger a further, final round of mergers that will result in two giant transcontinental rail systems. Furthermore, numerous prior proceedings and forums to examine the condition of the rail industry have revealed growing dissatisfaction with the adequacy of service, unnecessarily high rates, and anti-competitive policies that currently plague the rail industry.

The concern over further consolidation of the rail industry, coupled with a widespread belief that current polices do not promote a strong, efficient and competitive rail industry, provide the STB with ample justification to change its merger policy and other policies that shield the major railroads from the forces of competition. CURE recommends that the STB make the following changes to merger policy, as well as general rail policy:

1. The STB should adopt stronger merger review guidelines that evaluate each merger's impact on competition and apply the following requirements as a precondition to future mergers or consolidations between major railroads:

    - A demonstration that an increase in competitive options will be available to shippers following a merger.

    - A requirement that no merger will be approved that reduces transportation alternatives available to current railroad customers, including an analysis beyond any "bottleneck" affecting a rail shipper.

    - A requirement that no merger will be approved that fails to provide additional options and enhanced service for railroad customers.

2. The STB should reverse its current policy regarding "bottlenecks" and adopt a new policy requiring railroads to quote a rate between any two points on its system where traffic can originate or be interchanged;

3. The STB should affirmatively grant the right of Class I and small railroads to interchange at terminal areas and interchange points without being disadvantaged in any way in terms of operations or pricing; and

4. The STB should eliminate all "paper barriers" that arbitrarily restrict full interchange rights for Class II and III railroads.

In its initial comments in this proceeding, CURE asked that these changes to STB policy be adopted as a condition to any future rail merger in which the application is filed after January, 2000. CURE requested that these changes apply as general regulatory policy for all major railroads. To the extent that Ex Parte No. 582 is limited in scope to merger rules, CURE asks that the STB act on the voluminous record established by shippers, short line and regional railroads, the United States Department of Transportation (USDOT) and the United States Department of Agriculture (USDA), and initiate a separate rulemaking to address issues that have broader application than merger proceedings [3/] but are critical to the promotion of effective rail competition.

The USDOT and USDA Recognize the Problems that Plague the Rail Industry, and Recommend Pro-Competitive Mechanisms to Remedy Those Problems.

CURE agrees with the conclusion of both the USDOT and the USDA that further consolidation in the rail industry is a low return, high risk proposition for shippers. As the USDOT points out, "a recently completed research study commissioned by the FRA confirms the results of earlier studies: it finds that there are few or no such scale economies that can be realized from end to end mergers."[4/] Shippers currently face a major rail industry whose few players are able to use their market power to erect barriers to prevent the development of meaningful competition. The USDA observes that "effective competition 'to meet the needs of the public' must include effective inter-railroad competition – the kind that minimizes the number of captive shippers and the need for regulatory control over rates and service." [5/]

The prospect of a future transcontinental Class I rail duopoly is daunting to shippers, but so to is the current condition of a Class I railroad duopoly in the East and Class I rail duopoly in

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3/ 49 C.F.R. § 1110.2.

4/ USDA Comments at 13.

5/ USDA Comments at 15.

the West. CURE agrees with the USDA in concluding that "due to the erosion of inter-railroad competition and deficiencies in present rail service, [USDA believes that] large railroads should be required to improve competition and service to their existing shippers before they are allowed to become larger."[6/] The STB must take action to enact broad regulatory changes that apply uniformly to all major railroads and promote effective competition by removing competitive barriers.

Both the USDA and the USDOT recognize the importance of increasing competitive options to rail shippers. The USDOT explicitly recommends amending the STB's procedures for bottleneck relief as a mechanism to expand competitive options for shippers. And while CURE concurs with USDOT that bottleneck relief is an appropriate and effective mechanism to expand competition, CURE questions USDOT's assertion that the STB lacks the statutory authority to provide effective bottleneck access. In its examination of bottleneck relief, the USDOT points out, "requiring a contract in a bottleneck situation is no guarantee that the contract will be acceptable, either in terms of rates or service, to the shipper." [7/] Shippers have reached a similar conclusion. Moreover, there is little assurance today that a potential railroad competitor will even provide a contract to the bottleneck shipper. The more effective approach to bottleneck relief is to adopt a policy that requires railroads to quote a rate between any two points on its system where traffic can originate or be interchanged.

CURE believes strongly that bottleneck relief operates to expand competitive options and is within the STB's broad conditioning authority for mergers.[8/] CURE further believes the STB has the statutory authority to apply this rule to the entire industry and should initiate a separate rulemaking to do so. In our initial comments in this proceeding, CURE requested that the STB, where it lacks the authority to institute a rule change, notify Congress of its lack of statutory

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6/ USDA Comments at 23.

7/ USDOT Comments at 16.

8/ 49 U.S.C.§ 11324(c)

authority to adopt a specific reform necessary to protect shippers and enhance competition.

The Major Railroads Recognize that the Status Quo No Longer Serves the Public Interest, Yet Fail to Embrace Pro-Competitive Policies as a Remedy.

Despite the fact that the proposed merger between BNSF and CN has created disharmony among the normally unified Class I railroads, it is interesting to note that all basically concede that the status quo no longer serves the public interest. BNSF and CN logically are concerned that significant regulatory changes in this proceeding could dim their chances for merger approval or operate to impose conditions, post merger, that apply only to them. The remaining major railroads, less than enthusiastic at the prospect of launching into responsive mergers at this point in time, generally endorse a stricter standard for review of future mergers. It seems that the only position shared in common by the major railroads in this proceeding is continued opposition to a regulatory framework that will compel them to operate in a truly competitive environment.

CURE has not taken a position on the proposed merger between BNSF and CN. Still, the specter of a final round of mergers resulting in a transcontinental duopoly poses potentially serious consequences, likely all negative, for rail shippers. That being the case, CURE agrees with Union Pacific Railroad Company's (UP) premise for a new merger standard:

> The Board should evaluate the impact of and need for any additional Class I mergers on the assumption that any such merger is part of an "end game" resulting in transcontinental mergers and only two major railroads in North America. It should condition any mergers it approves in a manner that protects the public interest and shipper interests under that structure.[9]

For the coal fired electric utilities that are the railroad industry's largest customer, and for the chemical companies that rank second and provide carriers with approximately $5 billion in annual freight revenue, the "shipper interest" means policies that promote increased competition in the rail industry.

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[9] UP Comments at 3, 4.

Railroad proposals to impose service integration plans, increase disclosure requirements and require additional analyses are measures that are supported by shippers, but they amount to little more than a fig leaf in addressing the real issue – the current lack of competition in the industry today and the potential for even less competition in a further consolidated national rail industry. CURE supports the STB adopting strong, pro-competitive merger rules that places the burden of proving positive benefits for competition squarely on the shoulders of the merging railroads. Merging railroads should bear the onus of demonstrating that a merger will increase competitive options and enhanced service for shippers and will not reduce transportation alternatives available to any current shipper.

Beyond enhanced merger review standards, the STB should adopt policies that will promote "downstream effects" that are pro consumer and pro competitive. Merging railroads should have to live under new, pro-competitive rules. As the Kansas City Southern Railway Company (KCS) appropriately notes in their comments, "the existing academic research confirms that rail rates are significantly related to the degree of competition. This research indicates a significant relationship between rates and rail competition, establishing that added competition causes lower rates.[10/] It follows, then, that pro-competitive policies are needed to effectively counter the loss of competition that results when major railroads combine. CURE believes that merged railroads should be subject to pro-competitive policies – a change in the bottleneck policy, fair access at interchange points, and the removal of paper barriers.

CURE also agrees with BNSF that it may be unfair to apply new policies that enhance competition – including a change in bottleneck policy, fair access at interchange points, and removal of paper barriers – only to those railroads which merge after a certain date. As BNSF notes, "such a policy would discriminate against shippers served by merging carriers."[11/] CURE

10/ KCS Comments at 16.

11/ BNSF Comments at 21.

concurs, and believes that the STB should commence a separate proceeding to develop pro-competitive rules that have industry-wide application.

The Railroads Fail to Offer a Persuasive Argument Against Providing Bottleneck Relief to Enhance Competitive Options for Shippers.

Finally, CURE takes issue with the continued retrenchment on the part of the major railroads regarding bottleneck relief. BNSF states that it opposes any change to the bottleneck decisions based on "well grounded railroad economics" and "supported by the industry's need to earn adequate revenues to generate the capital needed for infrastructure and equipment investment."[12/] KCS also opposes changing bottleneck policy, and makes the contradictory argument that a reversal of the bottleneck decision "would leave regional railroads at the mercy of the large Class I railroads. Those larger Class I's will reach into the regional railroads' markets and, by means of their much broader market coverage, take traffic from the regional railroads to such an extent as to drive smaller carriers out of existence.[13/] BNSF fears that the competition resulting from bottleneck relief will impede their ability to hold customers captive, while KCS believes that large railroads such as BNSF will be the winners if bottleneck relief is granted. The only logical conclusion is that bottleneck relief will inject much needed competition into an industry that believes it has the right to exploit its customers, offers poor service and keeps rates unreasonably high.

Finally, Norfolk Southern Railway Company (NS) makes the frail argument that bottleneck relief would give "captive shippers that pay differentially higher rates the ability to use artificial rail-to-rail competition to drive down rates and transfer revenues from the rail industry to captive customers."[14/] Again, a major railroad articulates some sort of "right" to hold

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12/ BNSF Comments at 25.

13/ KCS Comments at 17.

14/ NS Comments at 41, 42.

customers captive in order to extract maximum revenues from them. CURE fails to understand how a policy that gives shippers access to a choice among railroads for a portion of a route is "artificial rail-to-rail competition." There is nothing "artificial" about a policy that uses competition to mitigate what is already overwhelming market dominance by the few remaining major railroads. As USDOT notes,

> "Although recent research establishes that railroading is still a decreasing cost industry, and thus requires differential pricing to recover full costs, differential pricing can be compatible with an efficient access price for the bottleneck, namely, a price that could permit a more efficient carrier than the incumbent to capture the business."[15]

Shippers need policies that provide yardstick competition in an industry that currently operates as a duopoly in the East and a duopoly in the West, and could soon consolidate into a transcontinental duopoly. For this reason, CURE asks the STB to reverse its bottleneck policy and require railroads to quote a rate between any two points on its system where traffic can originate or be interchanged. Such a policy should be adopted in this proceeding as a condition of merger. The STB should also initiate a separate proceeding to apply the same change to all Class I railroads operating in the United States.

15/ USDOT Comments at 16.

Conclusion.

The comments received by a vast array of shippers dependent on rail transportation, from regional and short line railroads, and from state and federal agencies are nearly unanimous in their request that the STB take decisive action and make effective competition the centerpiece of rail policy. The comments from all stakeholders in the industry, including the major railroads, urge the STB to establish a modern rail policy that protects the public interest. For shippers, the public interest is served by a merger policy focused on impacts to competition, by rules that allow competitive alternatives for captive shippers, and by actions that facilitate healthy regional and short line railroads throughout the U.S.

CURE urges the STB to act decisively and comprehensively. If the STB lacks the authority to act, the Board must give Congress the direction it needs to provide the STB the authority necessary to establish pro-competition national rail policy in the 21st century.

Respectfully Submitted,

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June 5, 2000

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of all filings submitted so far in this proceeding by the Consumers United for Rail Equity upon each person added to the official service list compiled by the Secretary in this proceeding by first-class mail, postage pre-paid.

Dated at Washington, D.C. this 5th day of June, 2000.

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